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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

IN THE MATTER OF THE JOINT
APPLICATION BETWEEN CITIZENS
UTILITIES COMPANY; AGUA FRIA
WATER DIVISION OF CITIZENS
UTILITIES COMPANY; MOHAVE WATER
DIVISION OF CITIZENS UTILITIES
COMPANY; SUN CITY WATER
COMPANY; SUN CITY SEWER
COMPANY; SUN CITY WEST UTILITIES
COMPANY; CITIZENS WATER
SERVICES COMPANY OF ARIZONA;
CITIZENS WATER RESOURCES
COMPANY OF ARIZONA; HAVASU
WATER COMPANY AND TUBAC
VALLEY WATER COMPANY, INC., FOR
APPROVAL OF THE TRANSFER OF
THEIR WATER AND WASTEWATER
UTILITY ASSETS AND THE TRANSFER
OF THEIR CERTIFICATES OF PUBLIC
CONVENIENCE AND NECESSITY TO
ARIZONA-AMERICAN WATER
COMPANY AND FOR CERTAIN
RELATED APPROVALS.

Docket No. W-01032A-00-0192
Docket No. W-01032B-00-0192
Docket No. W-01032C-00-0192
Docket No. W-01656B-00-0192
Docket No. SW-2276A-00-0192
Docket No. WS-02334A-00-0192
Docket No. WS-03454A-00-0192
Docket No. WS-03455A-00-0192
Docket No. WS-02013A-00-0192
Docket No. W-01595A-00-0192
Docket No. W-01303A-00-0192

RUCO'S BRIEF ON THE SHARING OF GAIN

Introduction

In compliance with the Hearing Officer's instructions at the conclusion of the hearing in this matter, RUCO hereby submits its Brief on the issue of whether Citizens' gain on the sale to Arizona American should be shared with ratepayers.

1 Fundamental principles of fairness, embodied in the Arizona Constitution and reinforced
2 by subsequent case law, support gain sharing under the circumstances presented. Article 15,
3 section 3 of the Arizona Constitution requires the Corporation Commission ("Commission") to
4 set "just and reasonable rates." The Commission's authority in this realm is exclusive and
5 plenary. *E.g. Ethington v. Wright*, 66 Ariz. 382, 395, 189 P.2d 209, 218 (1948).

6 Undeniably, Commission precedent does not preclude sharing the gain in this
7 transaction. Read in context, both the Commission decisions on point and precedent from
8 other jurisdictions permit sharing of the gain in certain circumstances. However, in this case,
9 ratepayers who have borne the economic risk associated with the assets Citizens is now
10 selling deserve, by application of simple economic risk/benefit theory, to share with Citizens'
11 shareholders \$71.2 million of gain to be realized on the transaction.

12 13 **Gain Sharing Must be Determined on a Case-by-Case Basis**

14 First, clear Commission precedent requires this determination to be made on a case-by-
15 case basis. In *Joint Application of Contel of the West and Citizens Utilities Co., Decision No.*
16 *58819* (attached as appendix A), the Commission expressly acknowledged that the facts and
17 circumstances of a particular asset transfer should determine whether any gain should be
18 shared with ratepayers. Additionally, the Commission implicitly acknowledged that such a
19 sharing was within the Commission's authority and appropriate under certain circumstances.

1 **Gain Must Follow Risk: Fairness Requires Gain Sharing in this Case**

2 Second, fairness, and the facts and circumstances of this case warrant sharing of the
3 gain. RUCO's witness testified that "The parties that share in the risks related to utility assets
4 should be entitled to share in the gain on the sale of those utility assets." Direct Testimony of
5 Gordon Fox ("Fox Direct"), August 2000, at 10; see also Surrebuttal testimony of Gordon Fox
6 ("Fox Surrebuttal"), September 2000, at 4. Mr. Fox goes on to illustrate how utility ratepayers
7 insulate utility shareholders, in effect, from normal business risk by the regulatory accounting
8 treatment of depreciation. *Id.* In Mr. Fox's illustration, "[t]his [accounting] treatment [of
9 depreciation] transfers the risk of assets becoming obsolete or wearing out prematurely from
10 the utility to the ratepayers." *Id.*

11 The practical impact of such regulatory accounting, as well as of monopoly regulation
12 generally, reduces risk to shareholders and increases risk to ratepayers in a way that is unique
13 to the regulatory environment. See Fox Surrebuttal at 5. If, as fairness demands, gain is to
14 follow risk, then ratepayers must be permitted to share in the gain, including gain measured as
15 an intangible such as good will. *Id.* at 7.

16 A recent decision from New York upheld the New York Public Service Commission's
17 order to share a gain with ratepayers, concluding that gain sharing was a rational way to
18 compensate those who had undertaken economic risk and helped, by paying rates, to build the
19 asset. See *New York Telephone v. Public Service Commission*, 2000 N.Y. Int. 71 (June 13,
20 2000)(copy attached as appendix B). "Even if, as NYT contends, the risk of any loss on the
21 sale of Bellcore would have been exclusively borne by NYT's shareholders, the reality was that
22 *in fully funding the Bellcore investment through telephone rates, NYT's customers effectively*
23 *eliminated that risk, guaranteed the maintenance of Bellcore's value and funded Bellcore*
24

1 dividends to shareholders, including NYT (see, *Democratic Central Comm. of the District of*
2 *Columbia v. Washington Metro. Area Tr. Commn.*, *supra*, 485 F2d, at 806 [an investor can
3 hardly muster any equitable support for a claim to appreciation in asset value where he has
4 been shielded against the risk of loss on his investment, or has already been rewarded for
5 taking on that risk.]” (Emphasis added.) Citizens’ reasoning that ratepayers incur no risk for
6 which they are entitled to compensation must be rejected for the very reasons stated in *New*
7 *York Telephone*. Citizens’ ratepayers funded the assets subject to transfer through rates. In
8 effect, the ratepayers eliminated the risk of loss, and guaranteed the maintenance of Citizens’
9 assets, while at the same time funding dividends to Citizens’ shareholders. Clearly, ratepayers
10 are entitled to compensation for their economic risk.

11 Citizens’ draws an analogy between utility rates and rent paid by tenants. See Rebuttal
12 Testimony of Carl W. Dabelstein (“Dabelstein Rebuttal”) at 7. When the owners sell the
13 building, goes the reasoning, tenants have no claim to any appreciation on the real estate
14 because they have no “equity interest.” This general rule may hold true in an unregulated
15 environment where competition flourishes. That is, a tenant may choose to move from one
16 building to another if the rent is unacceptable. In the regulated environment, however, the
17 “landlord” utility owns all the apartments in town. Only regulation intercedes as a means of
18 checks and balances, which substitutes for the market checks otherwise imposed by
19 competition.

20 A major reason that a purchaser – in this case, Arizona American – may be willing to
21 pay a dramatic premium for a regulated utility is for its protected, monopoly status, conferred
22 by the Commission. The customer base in such a transaction is guaranteed by the transfer,
23 along with the tangible assets that make up a utility’s fair value rate base, of a captive
24

1 ratepaying clientele. The existence of this clientele *insures* the purchaser against loss in
2 significant measure, whereby ratepayers share in the risks undertaken by the new owner of the
3 utility. Because the purchaser shoulders less risk, and because the ratepayers shoulder their
4 share of risk, a 50/50 sharing of the gain, or some comparable financial compensation to
5 ratepayers, is the only means of assuring "just and reasonable" rates under the Constitution.
6 See Fox Direct at 31; Fox Surrebuttal at 4. As RUCO's witness testified, "Cash flows from the
7 sale of assets are no less significant in the determination of fairness than the revenues
8 generated by a utility's filed tariffs. There is no requirement that ratepayers must have taken
9 an equity interest in assets to be entitled to a fair share of any gain resulting from the sale of
10 those assets in which ratepayers have shared economic risk." Fox Surrebuttal at 4.

11 12 **Citizens' Position is Not Supported by Precedent**

13 In response to RUCO's recommended gain sharing, Citizens presented the rebuttal
14 testimony of its witness, Carl W. Dabelstein, who opines, "[t]he Commission does not require
15 the sharing of gains on the sale of a business." Dabelstein Rebuttal at 4.

16 RUCO does not dispute this statement, or the fact that, in the decisions cited by Mr.
17 Dabelstein, the Commission did not order a sharing of the gain. RUCO does dispute the
18 unsupported assertion that the Commission *may not* order a sharing of the gain under the
19 circumstances presented *in this case*. Citizens simply fails to recognize this important
20 distinction. Moreover, the following cases cited by Mr. Dabelstein do not support Citizens'
21 assertion.

1
2 **1. Decision No. 57647**

3 *In the Matter of the Joint Application of Southern Union Gas Company and Citizens*
4 *Utilities Company, Decision No. 57647*, the Commission approved a sale of assets by
5 Southern Union to Citizens. As Mr. Dabelstein notes in his rebuttal testimony, the sale in
6 question generated a substantial gain, but the Commission did not order that the gain be
7 shared with ratepayers. Dabelstein Rebuttal at 4. Additionally, "Southern Union retained no
8 further business interests in [Arizona after consummation of this transaction.]" *Id.* Citizens'
9 reliance on this decision is puzzling.

10 In Decision No. 57647, no party, RUCO included, advocated a sharing of the gain. It is
11 not astonishing, therefore, that the Commission did not order it. The Commission did take
12 pains to discuss whether ratepayers would benefit from the transaction, and vowed to consider
13 any ratepayer benefit, or lack thereof, in the context of Citizens' future efforts to recover the
14 acquisition adjustment on the transaction. Decision No. 57647 at 7-8. The Decision contains
15 no discussion whatever of how to treat Southern Union's gain, and therefore offers little
16 precedential insight into the question at hand. Certainly, the case does not stand for the
17 proposition that the Commission could not have ordered a sharing of the gain had a party
18 advocated such a position, or had the Commission chosen to so order.

19
20 **2. The Contel of the West Transaction, Decision No. 58819**

21 This decision, also cited by Mr. Dabelstein, concerns the acquisition by Citizens of
22 certain assets of Contel of the West, a transaction that yielded a substantial gain over book
23 value for Contel. Dabelstein Rebuttal at 4. As above, Contel retained no further telephone
24

1 operations in Arizona after closing the sale to Citizens. *Id.* In the Contel case, Commission
2 Staff advocated a 50/50 sharing of the gain with ratepayers, *id.* at 5, a position not adopted by
3 the Commission in Decision No. 58819. Identifying the Commission's rationale for rejecting
4 Staff's position, however, is not as simple as Citizens would have the Commission believe.

5 While the decision does not require sharing of the Contel gain with ratepayers, the
6 rationale for this outcome is not expressly set forth. The decision, which stretches some 28
7 pages, recites the arguments for and against gain sharing raised by both Staff and Contel,
8 without commenting on which arguments it found to be dispositive or giving any indication of
9 what arguments it found to be informative or persuasive.

10 Indeed, absent such guidance from the Commission, few if any generalizations can be
11 made about Commission policy from the language of Decision No. 58819, Citizens' assertions
12 to the contrary notwithstanding. In rendering the Decision, the Commission clearly could
13 have, but did not, select which of Staff's reasons for gain sharing it rejected, if any, or which of
14 Contel's reasons it accepted, if any. One conclusion the Commission did not express is that
15 gain sharing on the sale of an entire business "with traffic" *precludes* the Commission from
16 ordering a sharing of the gain. In the decision's lengthy recitation of the arguments posited by
17 both sides, no particular circumstance or set of circumstances is identified as the *sine qua non*
18 of the Commission's decision not to require sharing of the gain. Any conclusion to the contrary
19 overstates the decision's value as precedent.

20 Citizens does nothing more than speculate as to the Commission's reasoning in
21 Decision No. 58819 with its attempts to tie the outcome in that decision to facts which it deems
22 to be favorable in the instant case. Citizens may not pick and choose which of the recited
23 arguments or case-specific facts the Commission might have relied upon in reaching its
24

1 conclusion. As noted above, the discussion contained in the decision does not rank or
2 differentiate these characteristics in any manner. It is impossible to conclude, for example,
3 that the seller's "exiting the state" was not the determining factor. Decision No. 58819 at 6 n.3.
4 In the instant case, the seller is clearly not exiting the state, but rather will continue to provide
5 telephone and gas service in Arizona.

6 Litigants may glean as much from what the Commission does *not* say, particularly when
7 it states its rationale so clearly in the same decision on numerous other issues. For example,
8 the decision concludes a section regarding the acquisition adjustment thus: "In order to protect
9 the public interest and assure that ratepayers are not harmed by the Citizens' acquisition, we
10 will prohibit Citizens from including any part of the acquisition adjustment from this transaction
11 into rates." Such a statement, notably absent as to the gain sharing issue, clearly sets forth
12 the Commission's thinking, and can legitimately be cited as support for the outcome. The lack
13 of such an express conclusion as to gain sharing limits the decision's value as precedent for
14 Citizens' position.

15 Moreover, the Commission expressly limits the precedential reach of its conclusion on
16 gain sharing, stating merely that gain sharing "is not appropriate *in the instant transaction*"
17 (emphasis added); that it "is not mandated by previous Commission decisions"; and that the
18 Commission will continue to decide the outcome of this issue on a "case-by-case basis."
19 Decision No. 58819 at 7. These conclusions do not support Citizens' position in the case at
20 bench.

1
2 **3. Decision No. 62648**

3 The final Arizona decision cited by Citizens in its Rebuttal Testimony approved a
4 settlement agreement between GTE California and Citizens wherein Citizens purchased
5 telephone assets from GTE at a premium, generating a gain for GTE. Mr. Dabelstein's
6 testimony concludes: "Although it did not discuss the gain on the sale, no portion was required
7 to be shared." Again, RUCO does not dispute this statement. However, two points bear
8 mention: first, the fact that the decision contains no discussion of the gain sharing issue
9 severely limits the decision's value as precedent. Second, the omission of a premium sharing
10 provision is not surprising given that the Decision adopts a settlement agreement. For reasons
11 known only to each party, a settled agreement was reached. It would be reasonable to
12 conclude from the omission of a gain sharing provision that the parties to the transaction did
13 not wish to create gain sharing precedent. In any event, this Decision does not support
14 Citizens' assertion that the Commission has a policy of rejecting gain sharing under the
15 circumstances presented.

16 In light of the foregoing discussion of Citizens' proffered precedent, Mr. Dabelstein's
17 conclusion that RUCO's position on gain sharing "deviate[s] from settled regulatory practice" is
18 misleading. Dabelstein Rebuttal at 7. More accurate, and less self-interested, is the
19 conclusion enunciated in the encyclopedic decision rendered by the Commission in 1988 *In*
20 *the Matter of the Application of Arizona Public Service Co.*, Decision No. 55931. There, in a
21 ten-page long discussion of the very issue of regulatory precedent on the sharing of gains
22 associated with sales of utility assets, the Commission concludes:

23 Since there is no existing judicial precedent in Arizona on the proper ratemaking
24 treatment of the gains from sales of utility property, we have carefully reviewed

1 the decisions of other regulatory commission and the judicial decisions in
2 jurisdictions. If those decisions were so uniform that it could be fairly said that
3 they expressed a widely accepted, common understanding of a general rule in
4 the ratemaking field, they could be persuasive. That certainly can not be said
5 about the decisions on treatment of the gains from sales of utility property. To the
6 extent any general principles can be gleaned from the decisions in other
7 jurisdictions they are: (1) the utility's stockholders are not automatically entitled to
8 the gains from all sales of utility property; and (2) ratepayers are not entitled to all
9 or any part of a gain from the sale of property which has never been reflected in
10 the utility's rates."

11 Decision No. 55931 at 54-55 (citations omitted; emphasis original). Citizens claim of "settled
12 regulatory practice" is overstated.

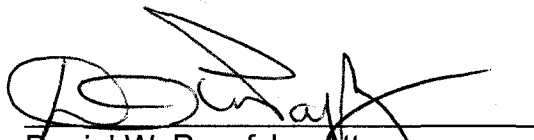
13 **Gain sharing is appropriate in this case**

14 Fundamental principles of fairness dictate that ratepayers share in the gain. This
15 Commission has recognized this principle of fairness in situations where there are gains as
16 well as losses. *In the Matter of the Application of Southwest Gas Co.*, Decision No. 57075 at
17 62, *In the Matter of the Application of Arizona Public Service Co.*, Decision No. 55931, at 55.
18 There is a rational basis for sharing the gain with ratepayers since Citizens' ratepayers
19 subsidized the appreciation in value of the assets while bearing the economic risk. See *New*
20 *York Telephone v. Public Service Commission*, *Id.* at 5-6. Had the assets decreased in value
21 to the point of placing Citizens' in financial peril, are we to believe that Citizens' would not seek
22 a rate increase? Ratepayers have an interest in contributing towards Citizens' financial
23 stability. Ratepayers depend on the service. Likewise, Ratepayers should share in the
24 benefits of an increase in value.

1 **Conclusion**

2 The Commission has the undisputed authority to order gain sharing here. A 50/50
3 sharing of the gain is a reasonable and appropriate means of compensating ratepayers for the
4 risks they have helped Citizens to shoulder.

5 RESPECTFULLY SUBMITTED this 11th day of October, 2000.

6
7 
8 Daniel W. Pozefsky, Attorney
9 Jessica Carpenter, Attorney
10

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13 October, 2000 with:

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APPENDIX A

Arizona Corporation Commission

DOCKETED

BEFORE THE ARIZONA CORPORATION COMMISSION

JUN 17 1994

MARCIA WEEKS
CHAIRMAN

RENZ D. JENNINGS
COMMISSIONER

DALE H. MORGAN
COMMISSIONER

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IN THE MATTER OF THE JOINT) DOCKET NO. U-1514-93-169
APPLICATION OF CONTEL OF THE WEST,) DOCKET NO. E-1032-93-169
INC., AND CITIZENS UTILITIES)
COMPANY FOR APPROVAL OF THE SALE OF) DECISION NO. 58819
ASSETS AND TRANSFER OF CERTIFICATES)
OF CONVENIENCE AND NECESSITY FROM)
CONTEL OF THE WEST, INC. TO)
CITIZENS UTILITIES COMPANY.)

OPINION AND ORDER

DATE OF HEARING: June 8 and 9, 1994

PUBLIC COMMENT: May 19, 1994

PLACE OF HEARING: Phoenix, Arizona

PRESIDING OFFICER: Richard N. Blair

APPEARANCES: Ms. Beth Ann Burns, Senior Counsel-Arizona,
on behalf of Citizens Utilities Company;

Mr. Thomas R. Parker, Attorney, on behalf of
GTE Telephone Operations;

Ms. Elaine A. Williams, Staff Attorney, on
behalf of the Residential Utility Consumer
Office; and

Mr. Paul A. Bullis, Chief Counsel, and Ms.
Karen D. Nally, Staff Attorney, Legal
Division, on behalf of the Utilities
Division of the Arizona Corporation
Commission.

BY THE COMMISSION:

On June 30, 1993, Contel of the West, Inc., ("Contel West") and
Citizens Utilities Company ("Citizens") filed with the Arizona
Corporation Commission ("Commission") a joint application for approval
of the sale of certain telephone properties in Arizona and the
transfer of the attendant Certificate of Convenience and Necessity

1 ("Certificate") by Contel West to Citizens.

2 Intervention in this matter was granted to the Residential
3 Utility Consumer office ("RUCO") on September 13, 1993.

4 By Procedural Order issued February 9, 1994 the hearing in this
5 matter was scheduled to commence on May 19, 1994. By Procedural Order
6 dated May 25, 1994, the hearing was rescheduled to commence on June 8,
7 1994. A public comment session was held in Phoenix, Arizona on May 19,
8 1994.

9 The hearing was held as scheduled and concluded on June 9, 1994.
10 At the hearing, Citizens, Contel West, RUCO, and Staff were
11 represented by counsel and presented testimony. At the conclusion of
12 the hearing, the matter was taken under advisement by the Hearing
13 Officer pending submission of a Recommended Opinion and Order to the
14 Commission and the parties were given leave to file closing briefs in
15 lieu of closing arguments.

16 DISCUSSION

17 Contel West is an Arizona corporation engaged in the business of
18 providing telecommunications service to the public within portions of
19 Apache, Coconino, Gila, Greenlee, and Navajo Counties Arizona,
20 pursuant to authority granted by the Commission. Joint applicant,
21 Citizens, is a Delaware corporation certificated by the Commission to
22 provide telecommunications, electric, gas, water, and wastewater
23 service in Arizona. Citizens currently serves approximately 58,700
24 telecommunications customers in Mohave County, Arizona.

25 Citizens and Contel West entered into an Asset Purchase Agreement
26 ("Agreement") on May 18, 1993, whereby Contel West's Arizona telephone
27 properties and related assets will be sold to Citizens at a purchase
28 price of approximately \$88.6 million. Citizens will acquire marketable

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1 title to the telephone plant free of any liens or security interest,
2 and will acquire the contracts, rights, and business records
3 associated with such telephone properties. This transaction is part of
4 an agreement between Contel West's parent corporation, GTE Corporation
5 ("GTE"), and Citizens for the sale and purchase of approximately
6 500,000 access lines in ten states for a total purchase price of \$1.1
7 billion. Citizens and Contel West have also executed an Employee
8 Transfer Agreement to govern the transition of employment and employee
9 benefits. The parties anticipate a September 30, 1994 closing date
10 for the Arizona telephone properties.

11 The Contel West telephone properties which are the subject of the
12 Agreement include approximately 27,700 (as of June 1993) access lines
13 in the following exchanges: Alpine, Cibique, Greer, Hawley Lake,
14 Heber, Holbrook, McNary, Pinedale, Pinetop, Pinetop Country Club, Show
15 Low, Snowflake, Springerville, St. Johns, and Whiteriver. Citizens
16 intends to operate the acquired properties under the name "Citizens
17 Telecommunications Company of Arizona", which will be distinct from
18 its Arizona Mohave telecommunications service. However, Citizens does
19 intend to establish a centralized services location in Dallas, Texas,
20 which will provide service to both of Citizens' local telephone
21 operations. Mr. Robert S. Crum testified on behalf of Citizens that
22 Citizens and Contel West are negotiating a Continuation Services
23 Agreement wherein GTE will provide financial, accounting, billing,
24 data processing, and administrative services to ensure an orderly and
25 "seamless" transition of service providers. Contel West and Citizens
26 contend that approval of the sale of the telephone properties and
27 transfer of the attendant Certificates is in the public interest.
28 Citizens submits that the proposed transaction should be

unconditionally approved by the Commission since the joint applicants have, at a minimum, shown that the proposed sale and transfer is not detrimental to the public interest.

Staff indicated that from a technical and operational standpoint the current Contel West ratepayers will not be detrimentally affected by Citizens' acquisition. However, from an economic perspective, Staff and RUCO are concerned that the transaction exposes current Contel West ratepayers to potential new costs and/or detrimental financial implications which may result in increased rates. Accordingly, both RUCO and Staff believe that the sale is generally in the public interest, provided that certain conditions are imposed upon the Commission's approval of the acquisition. Staff has also recommended five technical and administrative recommendations to be adopted by the Commission in order for Citizens' acquisition of these telephone properties to be in the public interest. It is the imposition of these conditions by Staff and RUCO that requires further discussion.

REALIZATION OF GAIN

The transaction is characterized as a sale "with traffic", meaning "with customers," and includes the associated revenue streams and the right to net operating income in the future. The gain to be realized by Contel from the sale is the difference between the net book value¹ of the depreciable physical assets and the sales price less transaction costs. It is with respect to the treatment of the gain that Staff and GTE/Contel West have disagreed. RUCO did not present any testimony concerning this issue.

Staff recommended that any gain realized by GTE on the sale

¹ The net book value is represented by the original cost of the tangible physical asset less accumulated depreciation.

1 should be equally divided between ratepayers and shareholders, and
2 that ratepayers receive a one-time credit from Contel on their last
3 bill. Staff believes that ratepayers should be allocated 50% of the
4 gain since the value associated with revenue streams and future net
5 operating income is derived from the ratepayers. According to Staff,
6 its recommendation is generally consistent with the Commission's
7 policy regarding gains realized on sales of utility property. The
8 specific mechanism recommended by Staff to rebate a portion of the
9 gain to customers was chosen since Contel West will no longer have a
10 presence in the State and, therefore, will not have utility property
11 in which to invest the gain. Staff noted that although the ratepayers
12 did not assume the risk of the initial investment in the assets, the
13 shareholders of Contel West have been insulated from competition
14 within their certificated service territory as a public service
15 corporation and, therefore, should not receive 100 percent of the gain
16 which is attributable to the revenue stream from ratepayers.

17 Contel West characterizes the transaction with Citizens as a sale
18 of a complete business, or a sale of plant "with traffic," and not the
19 sale of individual depreciable tangible assets in the ordinary course
20 of doing business. Contel West believes that its gain in the
21 transaction should not be shared with, or rebated to, ratepayers for
22 the following reasons:

23 ♦ It is Contel, and not the ratepayers, that is the legal
24 owner of the tangible and intangible assets being sold, and
25 therefore, requiring Contel to rebate 50% of the gain to
26 ratepayers would constitute a governmental confiscation of
27 private property and a violation of the Constitution.

28 ♦ Staff's recommendation is contrary to regulatory treatment

1 accorded similar transactions by the Commission, contrary to
2 case law from virtually every other jurisdiction, violates
3 the law prohibiting "piecemeal ratemaking,"² and burdens
4 interstate commerce.

5 ♦ The Uniform System of Accounts, adopted by the Commission,
6 and Part 32 of the Rules and Regulations of the Federal
7 Communications Commission, provide that gains and losses
8 incurred in the sale of assets with traffic are "below-the-
9 line" items which would flow directly to the Company and not
10 the ratepayers.

11 → The gain increment above net book value is attributed to the
12 worth of the intangible assets associated with Contel's
13 Arizona telephone operations and ratepayers bear none of the
14 risk associated with the Company's intangible assets.

15 → The Commission policy in transactions involving the sale of
16 the complete business where the selling utility is exiting
17 the state subsequent to consummation of the transaction has
18 been to allow the selling company to retain 100% of the
19 gain.³ Consequently, the Commission has focused instead on
20

21 ² Contel explains in its brief that providing a credit on
22 customers bills to reflect a portion of the gain is equivalent to a
23 rate reduction based solely upon this transaction, and therefore, is
24 contrary to the prohibition against single-issue ratemaking in the
25 Arizona Constitution. Contel further argues that if the gain
26 sharing is labeled a rebate, rather than a rate reduction, Arizona
27 law still prohibits a rebate of tariffed charges.

28 ³ Contel's brief states that three recent opinions of the
Commission allowed the selling company to retain one hundred percent
(100%) of the gain where the transaction involved the sale of a
going concern with the utility exiting the state at the close of the
transaction. The cases cited were Southern Union Gas Company,
Decision No. 57647 (December 2, 1991); Chronicle Publishing Company,
Decision No. 58450 (November 3, 1993); and Rio Utility Company,
Inc., Decision No. 58639 (May 27, 1994).

1 the purchasing utility's treatment of the acquisition
2 adjustment treatment.

3 Although the Commission shares Staff's concern that ratepayers
4 not be placed at risk for paying for the gain realized by Contel West
5 when Citizens requests ratemaking treatment of the acquisition
6 adjustment, we agree with Contel that Staff's "gain sharing"
7 recommendation is not appropriate in the instant transaction. Nor do
8 we believe that the Commission should adopt Staff's recommendation
9 just to ensure that ratepayers receive a tangible benefit from the
10 transaction. Staff's "gain sharing" recommendation is not mandated by
11 previous Commission decisions and the Commission will continue to
12 decide this issue on a case-by-case basis.

13 ACQUISITION ADJUSTMENT

14 Although Citizens agreed with Staff's recommendation that the
15 ratemaking treatment of an acquisition adjustment be deferred until a
16 future rate proceeding, Citizens opposed the criteria recommended by
17 Staff to determine whether an acquisition adjustment will be
18 recoverable in the future. The acquisition adjustment is the
19 difference between the total cost to Citizens of the utility plant
20 acquired in excess of the net depreciated original cost value of the
21 plant acquired. Although the total purchase price cannot be precisely
22 determined at this time, it is estimated that the acquisition
23 adjustment will approximate \$45 million.

24 Staff's witness, Mr. David Daer, testified that the explicit
25 standards for recovery of an acquisition premium established in the
26 matter of Citizens' acquisition of the former Southern Union Gas
27 Company ("SUG"), Decision No. 57647 (December 2, 1991), are also
28 applicable to this transaction. Pursuant to Decision No. 57647, an

1 acquisition premium recovery will be recognized if the acquiring
2 utility can demonstrate clear, quantifiable and substantial benefits
3 to ratepayers related only to the acquisition. According to Staff, at
4 the time of seeking ratemaking treatment of the acquisition
5 adjustment, Citizens has the burden of proving savings stemming from
6 structural advantages which are afforded by the acquisition and
7 showing that there are savings beyond what could have or should have
8 been realized under continued Contel West ownership. Citizens opposes
9 this standard as unreasonable since it is based solely on quantifiable
10 cost savings and ignores non-quantifiable benefits which will be
11 provided to customers. RUCO recommended that the Commission prohibit
12 Citizens from future rate recovery of the acquisition adjustment in
13 this transaction. RUCO believes that the opportunity for the possible
14 recovery of the acquisition premium was provided to Citizens in
15 Decision No. 57647, since there was an expectation that Citizens would
16 be able to provide benefits to ratepayers that could not have been
17 attained under SUG's continued ownership. Mr. Smith testified that no
18 similar expectation in this matter was proven by Citizens and,
19 therefore, the Commission's denial of any recovery of the acquisition
20 premium is not inconsistent with Decision No. 57647.

21 RUCO believes that denial of recovery is consistent with the
22 Commission's observation in Decision No. 57647 that "Citizens must be
23 reminded that Arizona allows for a return on invested plant, not on
24 the sale price paid for the utility." In the alternative, RUCO
25 recommends that should the Commission not prohibit recovery of the
26 acquisition premium, then Staff's recommendation to utilize the
27 criterion established in Decision No. 57647 regarding the recovery of
28 an acquisition premium also be adopted in this proceeding.

1 Citizens believes that consideration of the recovery of the
2 acquisition adjustment should be deferred to future rate proceedings
3 and recommended that: the acquisition premium be recorded in FCC
4 Account 2005, Telephone Plant Acquisition Account, until such time as
5 Citizens seeks Commission approval to include all or some of the
6 acquisition adjustment in rates; and that to determine the amount of
7 the acquisition adjustment allowable in rates, the Commission should
8 compare the total operating expenses per access line for the test year
9 in the rate case to the average operating expenses per access line for
10 the last two years prior to Citizens' ownership of these properties.
11 Mr. Daer correctly points out that this comparison would not be
12 meaningful without attributing proper consideration and weight to the
13 current cost reduction trend established by Contel West with reference
14 to its Arizona properties. RUCO indicates that this recommendation
15 would permit Citizens to carry the balance in Account 2005
16 indefinitely, without any requirement for amortizing the balance of
17 the account below the line over a specified number of years. This,
18 according to RUCO, would place ratepayers at risk for the rate
19 inclusion of the acquisition premium for an indefinite period of time.

20 In order to protect the public interest and assure that
21 ratepayers are not harmed by the Citizens' acquisition, we will
22 prohibit Citizens from including any part of the acquisition
23 adjustment from this transaction into rates.

24 DEFERRED INCOME TAXES

25 Upon consummation of the sale to Citizens, all of Contel West's
26 deferred income taxes ("DIT") and investment tax credits ("ITC")
27 applicable to the Arizona properties will become due and payable, and
28 therefore, DIT will no longer function as an offset to rate base and

1 ITC will no longer reduce income tax expense. However, Mr. Daer
2 observed that Citizens would build up DIT subsequent to the sale and
3 prior to its first rate proceeding, therefore the actual effect or
4 impact on future rates attributable to the loss of Contel's DIT
5 offsets is presently unknown. Accordingly, Mr. Daer recommended, and
6 Citizens agreed, that: a ratemaking adjustment be deferred to a future
7 rate proceeding; and that for the remaining life of the assets being
8 purchased by Citizens, ratepayers should be at least as well off under
9 Citizens' ownership as they would under the continued ownership by
10 Contel West. However, Citizens agreed to defer the ratemaking
11 adjustment provided that the adjustment does not violate the
12 normalization provisions of the Federal Tax Code. According to Staff,
13 this ratemaking adjustment would be based upon the difference between
14 rate base under Citizens' ownership compared to what the rate base
15 would be under Contel West's ownership.

16 RUCO recommended that as a precondition to Commission approval
17 of the acquisition, Citizens be prohibited from challenging a future
18 ratemaking adjustment for lost DIT or ITC on certain specified
19 grounds. Additionally, RUCO recommended that the Commission order
20 Citizens to make available at the next rate case detailed accounting
21 and tax information, as well as knowledgeable personnel to answer
22 questions concerning this data during discovery. Citizens objected to
23 RUCO's requirement since the availability of knowledgeable Contel West
24 personnel at a future proceeding is unknown at this time.

25 We find Staff's recommendation is consistent with the
26 Commission's policy that ratepayers should be at least as well off
27 under Citizens' ownership as they would have been under the continued
28 ownership by Contel West. We believe that it is unnecessary to adopt

1 in this proceeding RUCO's recommendations pertaining to the conduct of
2 discovery proceedings involving DIT and ITC which may occur in a
3 future rate proceeding. Accordingly, we concur with Staff and Citizens
4 that the ratemaking treatment of DIT and ITC should be deferred to a
5 future rate proceeding.

6 DATA RETENTION

7 Staff recommended that Citizens acquire and retain historical
8 operating and financial data relating to the Contel West properties
9 for the past five years and that GTE/Contel West be required to assist
10 Citizens with the preparation of data requests in future rate
11 proceedings. RUCO generally supports Staff's recommendations, but
12 suggests that GTE/Contel West should be required, for a period of five
13 years after the closing, to make available to Citizens persons who are
14 knowledgeable concerning the interpretation of the accounting records.
15 Mr. Barry Johnson, testifying on behalf of GTE, indicated that a
16 continuation of services agreement being negotiated with Citizens
17 would include a provision for providing assistance with data
18 responses. Mr. Johnson, however, stated that even without that
19 agreement GTE would provide assistance to Citizens in the preparation
20 of data responses provided an appropriate compensation agreement
21 existed to compensate GTE.

22 Citizens objects to Staff's recommendation since GTE may not have
23 information for years prior to the merger of GTE and Contel in 1991
24 and argues that, the relevance of this information to a rate case
25 which cannot be filed until 1996 is suspect. With respect to the
26 availability of documents, GTE's witness stated that GTE maintained in
27 its possession all documents which it is obligated to keep pursuant to
28 the retention of records requirements of Part 42 of the FCC Rules and

1 Regulations. Additionally, Contel West agreed to provide Citizens with
2 all operating and financial data for GTE West-Arizona, for the time
3 prior to and subsequent to the merger, which is in its possession as
4 of the date of the closing.

5 Citizens also objected to Staff's recommendation which would
6 require GTE to assist in the preparation of data responses in future
7 rate proceedings since the availability of knowledgeable GTE/Contel
8 West personnel when discovery occurs in a future rate proceeding is
9 unknown. Citizens suggests that if this recommendation is adopted,
10 then the Commission should allow Citizens, for ratemaking purposes,
11 full recovery of all costs incurred in utilizing GTE/Contel West
12 personnel to comply with the Commission's order. However, we believe
13 that Citizens' request for the Commission's pre-approval of
14 speculative costs is inappropriate in this proceeding and should be
15 deferred to a future proceeding where recovery is actually being
16 sought by Citizens.

17 We find that Staff's recommendations are appropriate considering
18 the discovery problems encountered by Citizens in the first rate
19 proceeding following its acquisition of the Northern Arizona Gas
20 Division from Southern Union Gas. Staff's recommendations provide a
21 practical solution to avoid a situation wherein Citizens is unable to
22 provide meaningful answers to data responses which may require the
23 assistance of GTE or Contel West personnel. We also accept RUCO's
24 recommendation that GTE/Contel West should be obligated to provide
25 Citizens with knowledgeable personnel to interpret the data for a
26 period of five years after the sale, however, the compensation of
27 GTE/Contel West for this service is a matter to be negotiated between
28 the parties as a part of the overall purchase agreement, and will not

1 be determined by the Commission. Contrary to Citizens' objection, the
2 financial and historical data relating to the acquired Arizona
3 telephone properties may be relevant to evaluations to be performed in
4 future proceedings, and we believe that the recommendations of Staff
5 and RUCO will help to insure that relevant data is preserved and that
6 support is available to assist Citizens' ability to interpret the
7 data. Accordingly, we will adopt the recommendations of Staff and RUCO
8 as described herein.

9 COST ALLOCATION

10 Citizens did not oppose Staff's recommendation to require
11 Citizens to submit a draft of its cost allocation procedures prior to
12 filing its next general rate case. We concur with Staff's
13 recommendation.

14 RATES AND CHARGES

15 In its application Citizens indicated that it will adopt the
16 current rates, charges, terms and conditions for service found in the
17 existing Contel West tariffs. Staff has recommended that Citizens
18 agree not to file for a rate increase for at least two years from the
19 effective date of an order approving the transaction. Staff's
20 recommendation for a stay-out period was based upon Citizens'
21 testimony that an evaluation of the customer benefits to be derived
22 from combining the Contel West operations with Citizens existing
23 Mohave County telephone operations and/or its Arizona Gas Division
24 ("AGD") operations would not be completed for a "couple of years"
25 after the acquisition.

26 Citizens agreed to Staff's recommendation for a two-year rate
27 moratorium effective from the date of this Decision with the following
28 qualifications: that the Commission authorize the deferral of the

1 Transition Costs⁴ until after the moratorium period and thereafter
2 amortize the costs over a three year period; and, that the ratemaking
3 treatment of the Transition Costs be determined in a future
4 proceeding, provided however, that these costs are not included with
5 either the acquisition adjustment or the transaction costs in this
6 proceeding. Although Staff does not oppose Citizens' proposal to
7 defer and amortize the Transition Costs, Staff believes that the
8 appropriate ratemaking treatment of these Transition Costs should be
9 deferred to a future rate case. Accordingly, Staff also deferred to a
10 future rate proceeding a determination of whether the Transition Costs
11 should be included with the acquisition adjustment or the transaction
12 costs associated with the acquisition. Staff, however, did not oppose
13 Citizens proposal to allow new tariffs to be filed within the two year
14 moratorium period, provided other certificated telecommunications
15 companies have the ability to file for tariff changes and the proposed
16 tariff changes do not result in an increase in the rate of return for
17 the Contel West telephone properties.

18 RUCO opposes Citizens proposed treatment of Transition Costs and
19 recommends that the Commission defer ratemaking treatment of these
20 costs, along with other acquisition related costs, to a future rate
21 proceeding. According to RUCO, the Commission should reject Citizens'
22 proposal for deferral and amortization of the Transition Costs since
23 Citizens' request requires the Commission to approve in this
24

25 ⁴ Transition Costs were described by Mr. O'Brien as costs
26 Citizens has or will incur in reorganizing and expanding the
27 administrative and operational infrastructure as a result of the
28 acquisition of the GTE telephone properties. Citizens has incurred
these costs since August 1993 and estimates the amount to be
allocated to Arizona operations at approximately \$600,000 or
\$200,000 per year based upon a proposed three year amortization.
(Exhibit A-4, pp. 20-21, O'Brien Rebuttal)

1 proceeding the inclusion of Transition Costs into future rates. RUCO,
2 however, would not object to the Commission authorizing a deferral and
3 amortization of the Transition Costs, provided any such order contains
4 an explicit statement that the Commission is taking no position at
5 this time regarding the probability of future rate recovery. The order
6 should also require clear proof of structural cost savings resulting
7 from Citizens' ownership before including these costs in rates.

8 We believe that a two year rate moratorium is appropriate because
9 it will allow Citizens adequate time to gain familiarity with the
10 operation of the Contel West system and to evaluate possible operating
11 synergies and cost efficiencies to be derived from combining
12 operations with its Mohave County telephone operations and AGD
13 operations. Citizens agreed that two years was an appropriate period
14 of time in which to complete this evaluation. Accordingly, to permit
15 Citizens to increase rates prior to two years after the acquisition of
16 the Contel West properties would be contrary to the public interest.
17 This is consistent with the Commission's policy that ratepayers should
18 not be worse off from an economic standpoint as a result of this
19 transaction.

20 We also agree with Staff and RUCO that the determination of
21 future ratemaking treatment of Transition Costs should be deferred
22 until the next rate case and, therefore, will not agree at this time
23 to Citizens' request to exclude Transition Costs from the acquisition
24 adjustment or the transaction costs in this proceeding. We also
25 concur with RUCO that to the extent that these costs may be
26 recoverable, Citizens will have the burden of establishing that
27 quantifiable cost savings to ratepayers have been achieved beyond what
28 could have or should have been realized under continued GTE/Contel

1 West ownership. Although Citizens may elect to defer and amortize
2 Transition Costs, we will defer any ratemaking treatment of these
3 costs to a future rate case. We will also adopt the proposal
4 concerning the filing of new tariffs as agreed upon by Staff and
5 Citizens.

6 TARGET EXCELLENCE

7 RUCO's witness, Mr. Ralph Smith, believes that ratemaking
8 treatment of Target: Excellence costs should be established in this
9 proceeding and recommends that the Commission order Citizens to
10 maintain detailed accounting records of Target: Excellence program
11 costs for the acquired properties and to limit recovery of such costs
12 to proven savings. Citizens believes that the ratemaking treatment of
13 Target: Excellence costs is not a relevant issue in this proceeding
14 since no request was made in their application for any recovery of
15 these costs in current rates. In fact, Citizens has agreed to charge
16 Contel West's currently approved rates and to not file a rate case
17 during a two year stay-out period.

18 We agree with Citizens that the ratemaking treatment of Target:
19 Excellence costs should be deferred to a future rate case where
20 Citizens is seeking the inclusion of these costs in rates.
21 Accordingly, we will not adopt RUCO's recommendations as a pre-
22 condition to the approval of Citizens acquisition.

23 CUSTOMER BILLING SERVICES

24 Mr. Mark Shine testified that Citizens is negotiating to purchase
25 billing services from GTE's Customer Billing and Services System
26 ("CBSS") and characterizes the CBSS as a "world class system." (Ex.
27 A-3A, p. 17) Mr. Shine also testified that it is common practice in
28 the telecommunications industry to contract for billing services. RUCO

1 argued that ratepayers will not be better off after the acquisition as
2 it relates to billing services since Citizens has not demonstrated
3 that ratepayers will not be charged more for the CBSS system under
4 Citizens ownership, rather than Contel West's continued ownership.
5 Therefore, RUCO recommended that as a precondition to approving the
6 acquisition, the Commission should require GTE to provide cost data on
7 the billing services so that Citizens' CBSS billing costs could be
8 measured for ratemaking purposes.

9 Although we cannot determine in this proceeding whether Citizens
10 costs to utilize the CBSS billing system will be equal, greater or
11 less than, the costs under continued GTE ownership, we can determine
12 that ratepayers will maintain a similar level or quality of billing
13 services under Citizens ownership if the CBSS system is also utilized
14 by Citizens. We are not, however, determining that the CBSS system
15 must be used by Citizens or that the price paid to GTE for the service
16 is reasonable. Accordingly, we will not adopt RUCO's recommendation
17 and will defer the issue of the reasonableness of these costs and
18 their ratemaking treatment to a future rate case when Citizens seeks
19 to include these costs in rates.

20 GTE'S NONREGULATED AFFILIATES

21 RUCO recommends that the Commission require GTE to provide full
22 details concerning charges and rates of return of two of GTE
23 nonregulated affiliates, GTE Supply ("GTES") and GTE Data Services,
24 Inc. ("GTEDS"), as well as the rates of return earned by the
25 affiliates, as a precondition to approval of the acquisition.
26 According to RUCO, the data should be maintained by Citizens for
27 future rate proceedings.

28 GTE's witness, Mr. Johnson, testified that the FCC audit into

1 GTE's affiliated charges, and the subsequent FCC Consent Decree Order
2 AAD 95-35, covered a period of time prior to the Contel/GTE merger in
3 1991. Mr. Johnson opposed RUCO's recommendation since Contel West's
4 present rates were approved prior to the merger in 1991, GTE's
5 affiliates provided no services to Contel West prior to the 1987 test
6 year used in the last rate case, and, therefore, the existing Contel
7 West's rates do not include any GTED or GTES supply charges. Mr.
8 Johnson further states that RUCO's recommendation to analyze financial
9 data related to GTE's affiliates would be more appropriate in a rate
10 proceeding.

11 Since both parties agree that no overcharges from GTE affiliates
12 have been included in existing rates and that Citizens is required to
13 continue to charge these rates during the moratorium period, we agree
14 with GTE that to the extent financial data concerning these affiliated
15 entities is relevant, the issue should be deferred to the next rate
16 case. However, we also believe that GTE should provide to Citizens at
17 the time of closing all data in their possession relating to any
18 business dealings subsequent to the merger between the GTE affiliates
19 and the Contel West-Arizona properties. This data should include
20 details concerning the returns earned by GTES and GTEDS on their
21 transactions with Contel-West Arizona for the years that operation was
22 under GTE ownership. As previously discussed concerning data
23 retention, GTE should also be required to provide to Citizens,
24 knowledgeable personnel for five years after the closing to assist
25 Citizens with the interpretation of this data in future rate
26 proceedings.

27 . . .

28 . . .

TECHNICAL AND ADMINISTRATIVE RECOMMENDATIONSMAPS AND DESCRIPTIONS

Citizens agrees to Staff's recommendation that Citizens file maps and descriptions of the service territory that are identical to the maps and descriptions found in the Contel West tariff. Citizens agrees to amend any inaccurate maps and legal descriptions which were filed with their application in this matter. Accordingly, we concur with Staff and will adopt its recommendation.

UPGRADING SERVICE

Staff recommended that: Citizens undertake a study to determine the economic feasibility of upgrading the Greer and Hawley Lake exchanges from analog to digital switching; and, that Citizens conduct an engineering study of service improvements in the Blue River Valley and Richville areas, with the results to be reported within ninety days after completion of the transaction. Citizens does not oppose Staff's recommendations⁵. Although we adopt these recommendations, we will not give ratemaking treatment in this proceeding to the costs of the studies or analysis to be undertaken by Citizens. Ratemaking treatment is deferred to a future proceeding where Citizens is requesting inclusion of these costs into rates.

APPROVAL OF FRANCHISES

Citizens did not object to the following Staff recommendations: that the transfer not take place until necessary franchises are approved; and, that a conditional Certificate issue requiring Citizens to obtain the necessary franchises within one year from the effective date of this Decision. We concur with Staff's recommendation.

⁵ Citizens filed exceptions to the Proposed Order and requested 180 days in which to submit the results of its study.

REFUNDS AND NOTICES

Staff recommended that Citizens file with the Director of the Utilities Division a list of all refunds assumed by Citizens due for meter installations, security deposits, or main extension agreements. Staff does not oppose Citizens' request that it be allowed sixty to ninety days from the close of escrow to file that information. We will adopt Staff's recommendation and permit Citizens ninety days from the close of escrow to file the information with the Utilities Division.

Staff also recommended that Citizens provide notice to the affected customers of Contel West concerning the change in ownership at least fifteen days following the close of escrow, along with the name, address, and telephone number of Citizens' customer service department. However, Mr. Daer indicated that this recommendation would not prohibit Citizens from notifying customers of the transition in ownership prior to the close of escrow. Consequently, Citizens did not oppose Staff's recommendation and agreed to file a copy of the notice with the Director of the Utilities Division. Accordingly, we will adopt Staff's recommendations.

* * * * *

Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. Contel West is an Arizona corporation engaged in the business of providing telecommunications service to the public within portions of Apache, Coconino, Gila, Greenlee, and Navajo Counties Arizona, pursuant to authority granted by the Commission.

2. Citizens is a Delaware corporation certificated by the

1 Commission to provide telecommunications, electric, gas, water, and
2 wastewater service in Arizona.

3 3. Citizens currently serves approximately 58,700
4 telecommunications customers in Mohave County, Arizona.

5 4. On June 30, 1993, Contel West and Citizens filed a joint
6 application for approval of the sale of certain telephone properties
7 in Arizona and for approval of the transfer of the attendant
8 Certificate by Contel West to Citizens.

9 5. The proposed sale to Citizens of Contel West's Arizona
10 telephone properties includes approximately 27,700 access lines in the
11 following exchanges: Alpine, Cibique, Greer, Hawley Lake, Heber,
12 Holbrook, McNary, Pinedale, Pinetop, Pinetop Country Club, Show Low,
13 Snowflake, Springerville, St. Johns, and Whiteriver.

14 6. On May 18, 1993, Contel West and Citizens entered into an
15 Asset Purchase Agreement which established the purchase price for the
16 acquisition as \$88 million, subject to adjustments pursuant to the
17 Agreement.

18 7. The gain to be realized from the sale to Citizens is the
19 difference between the net book value of the depreciable physical
20 assets and the sales price, less Transaction Costs.

21 8. Contel West proposes to allow its shareholders to retain all
22 of the gain resulting from the sale of the Arizona telephone
23 properties to Citizens.

24 9. Neither Staff nor RUCO oppose the application, but both
25 believe the public interest would be served only if certain conditions
26 are adopted by the Commission.

27 10. The Commission finds that the following conditions to the
28 transfer are reasonable, appropriate, and necessary to protect the

1 public interest:

- 2 ♦ Contel West may retain 100% of the gain to be realized from
3 Citizens acquisition of its Arizona telephone properties.
- 4 ♦ For ratemaking purposes, we shall prohibit Citizens from
5 including any part of the acquisition adjustment for this
6 transaction into rates.
- 7 ♦ The ratemaking treatment of deferred income taxes and
8 investment tax credits be deferred to a future rate
9 proceeding and any adjustment would be based upon the
10 difference between rate base under Citizens' ownership
11 compared to what rate base would be under Contel West's
12 continued ownership.
- 13 ♦ For the remaining life of the assets being purchased from
14 Contel West by Citizens, the ratepayers should be at least
15 as well off under Citizens' ownership as they would be under
16 the continued ownership by Contel West.
- 17 ♦ Citizens shall acquire and retain historical operating and
18 financial data relating to Contel West properties for the
19 five years prior to the sale, GTE/Contel West shall assist
20 Citizens with the preparation of data responses in future
21 rate proceedings, and GTE/Contel West shall provide Citizens
22 with knowledgeable personnel to interpret the data for a
23 period of five years after the sale.
- 24 ♦ Citizens shall submit a draft of its cost allocation
25 procedures for review prior to filing its next rate case.
- 26 ♦ Citizens shall not file for increased rates for the acquired
27 Contel West telephone properties any earlier than two years
28 from the effective date of this Decision.

- 1 ♦ Citizens may file new tariffs and revise existing tariffs
2 relating to the acquired Contel West properties, to the
3 extent that other certificated telecommunications companies
4 in Arizona have the ability to file for tariff changes,
5 provided that the proposed tariff changes do not result in
6 an increase in the rate of return applicable to the newly
7 acquired properties.
- 8 ♦ Citizens shall file maps and descriptions of the service
9 territory that are identical to the maps and descriptions
10 found in the Contel West tariff.
- 11 ♦ Citizens shall undertake a study to determine the economic
12 feasibility of upgrading the Greer and Hawley Lake exchanges
13 from analog to digital switching, but ratemaking treatment
14 attributable to the costs of the studies is deferred to a
15 future rate proceeding where Citizens is requesting
16 inclusion of these costs into rates.
- 17 ♦ Citizens shall conduct an engineering study of service
18 improvements in the Blue River Valley and Richville areas,
19 and shall report the results of this study to the Director
20 of the Utilities Division within ninety days after
21 consummation of the closing. The ratemaking treatment
22 attributable to the costs of this study are deferred to a
23 future rate proceeding where Citizens is requesting
24 inclusion of these costs into rates.
- 25 ♦ The transfer between Contel West and Citizens not take place
26 until all necessary franchises needed prior to approval are
27 obtained.
- 28 ♦ Citizens shall receive a conditional Certificate of

1 Convenience and Necessity requiring Citizens to obtain all
2 necessary franchises within one year from the effective date
3 of this Decision.

4 ♦ Citizens shall file with the Director of the Utilities
5 Division a list of all refunds assumed by Citizens due for
6 meter installations, security deposits, or main extension
7 agreements, within ninety days of close of escrow.

8 ♦ Citizens shall notify affected Contel West telephone
9 customers of the transfer of ownership, along with the name,
10 address, and telephone number of Citizens' customer service
11 department, not later than 15 days of the close of escrow,
12 and file a copy of the notice with the Director of
13 Utilities.

14 ♦ Ratemaking treatment of Citizens Target: Excellence costs
15 should be deferred to a future rate proceeding where
16 Citizens is seeking inclusion of these costs in rates.

17 ♦ Ratemaking treatment for the purchase of billing services
18 from GTE's Customer Billing and Services System will be
19 deferred to a future rate proceeding when Citizens seeks to
20 include theses costs into rates.

21 ♦ GTE shall provide Citizens at the time of closing all
22 historical financial data in its possession concerning
23 charges and rates of return of GTE Supply and GTE Data
24 Services relevant to any business transactions subsequent to
25 the merger of GTE and Contel West in 1991. For a period of
26 five years after the close of escrow, GTE shall make
27 available to Citizens, knowledgeable personnel to assist in
28 the interpretation of this data in future rate proceedings.

CONCLUSIONS OF LAW

1
2 1. Contel West and Citizens are public service corporations
3 within the meaning of Article XV of the Arizona Constitution and
4 A.R.S. §§40-281, 40-282 and 40-285.

5 2. The Commission has jurisdiction over Contel West and
6 Citizens and of the subject matter of the application.

7 3. There is a continuing need for the provision of telephone
8 service to the public in Contel West's certificated service area.

9 4. Citizens is a fit and proper entity to receive the assets
10 and Certificate of Contel West.

11 5. Notice of the application was given in the manner prescribed
12 by law.

13 6. Subject to the conditions discussed in Finding of Fact No.
14 10, hereinabove, the transfer of the Certificate and assets of Contel
15 West to Citizens is in the public interest and should be approved.

ORDER

16
17 IT IS THEREFORE ORDERED that the joint application of Contel of
18 the West, Inc. and Citizens Utilities Company for approval of the sale
19 of assets and transfer of Certificates of Contel West's Arizona
20 telephone properties to Citizens is hereby granted.

21 IT IS FURTHER ORDERED that Citizens Utilities Company shall
22 charge Contel of the West, Inc.'s telephone customers the existing
23 rates and charges authorized by the Commission until a change in those
24 rates and charges is authorized by the Commission.

25 IT IS FURTHER ORDERED that Citizens Utilities Company shall not
26 file a general rate case requesting an increase in rates any earlier
27 than two years from the effective date of this Decision.

28 IT IS FURTHER ORDERED that Citizens Utilities Company may file

1 new tariffs and revise existing tariffs relating to the telephone
2 properties acquired from Contel of the West, Inc., to the extent that
3 other certificated telecommunications companies in Arizona have the
4 ability to file for tariff changes, provided that the proposed tariff
5 changes do not result in an increase in the rate of return applicable
6 to the acquired properties.

7 IT IS FURTHER ORDERED that for ratemaking purposes, we shall
8 prohibit Citizens Utilities Company from including any part of the
9 acquisition adjustment for this transaction into rates.

10 IT IS FURTHER ORDERED that GTE shall provide Citizens Utilities
11 Company at the time of close of escrow all historical financial data
12 for its Contel of the West, Inc. Arizona telephone properties for the
13 last five years, and Citizens shall retain the data for a five year
14 period. GTE shall also make available to Citizens Utilities Company
15 for a period of five years after close of escrow, knowledgeable
16 personnel to assist in the interpretation of the data and in the
17 preparation of data responses in future rate proceedings.

18 IT IS FURTHER ORDERED that GTE shall provide to Citizens
19 Utilities Company, at the time of close of escrow, all historical
20 financial data in its possession relating to charges and rates of
21 return of GTE Supply and GTE Data Services relevant to any business
22 transactions with Contel of the West, Inc. subsequent to the merger of
23 GTE and Contel of the West, Inc. GTE shall also, for a period of five
24 years after the close of escrow, make available to Citizens Utilities
25 Company knowledgeable personnel to assist in the interpretation of
26 this data and in the preparation of data responses in future rate
27 proceedings. This data should include details concerning the returns
28 earned by GTES and GTEDS on their transactions with Contel-West

1 Arizona for the years that operation was under GTE ownership.

2 IT IS FURTHER ORDERED that Citizens Utilities Company shall
3 submit a draft of its cost allocation procedures for review prior to
4 filing its next general rate case.

5 IT IS FURTHER ORDERED that Citizens Utilities Company shall file
6 a list of all customer refunds it has assumed with the Director of the
7 Utilities Division within 90 days of the completion of the transfer.

8 IT IS FURTHER ORDERED that Citizens Utilities Company shall
9 notify the affected Contel West telephone customers of the transfer of
10 ownership and shall also provide the customers with the name, address,
11 and telephone number of Citizens' customer service department. The
12 notice shall be mailed to customers not later than 15 days of the
13 completion of the transfer by close of escrow and Citizens shall file
14 a copy of the notice with the Director of the Utilities Division.

15 IT IS FURTHER ORDERED that Citizens Utilities Company shall file
16 maps and descriptions of the service territory that are identical to
17 the maps and descriptions found in the Contel of the West, Inc.
18 tariff.

19 IT IS FURTHER ORDERED that Citizens Utilities Company shall
20 undertake a study to determine the economic feasibility of upgrading
21 the Greer and Hawley Lake exchanges from analog to digital switching.

22 IT IS FURTHER ORDERED that Citizens Utilities Company shall
23 conduct an engineering study of service improvements in the Blue River
24 Valley and Richville areas, and shall report the results of this study
25 to the Director of the Utilities Division within 180 days after the
26 completion of the transfer by close of escrow.

27 IT IS FURTHER ORDERED that Citizens Utilities Company is granted
28 a conditional Certificate of Convenience and Necessity which requires

1 Citizens Utilities Company to obtain all necessary franchises within
2 365 days of the effective date of this Decision.

3 IT IS FURTHER ORDERED that approval of the transfer is
4 conditioned upon Citizens Utilities Company filing with the Commission
5 all necessary franchises within 365 days of the effective date of this
6 Decision.

7 IT IS FURTHER ORDERED that the ratemaking treatment of Target:
8 Excellence costs shall be deferred until a future rate proceeding for
9 Citizens Utilities Company.

10 IT IS FURTHER ORDERED that the ratemaking treatment of billing
11 services leased from GTE's Customer Billing and Services System shall
12 be deferred until a future rate proceeding for Citizens Utilities
13 Company.

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IT IS FURTHER ORDERED that the ratemaking treatment of deferred income taxes and investment tax credits shall be deferred until a future rate proceeding for Citizens Utilities Company.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

Barbara Weeks
CHAIRMAN

COMMISSIONER

Dale H. Morgan
COMMISSIONER

IN WITNESS WHEREOF, I, JAMES MATTHEWS, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 17 day of October, 1994.

James Matthews
JAMES MATTHEWS
EXECUTIVE SECRETARY

DISSENT _____
RB

SERVICE LIST FOR:

CONTEL OF THE WEST, INC. and
CITIZENS UTILITIES COMPANY

DOCKET NO.:

U-1514-93-169 and E-1032-93-169

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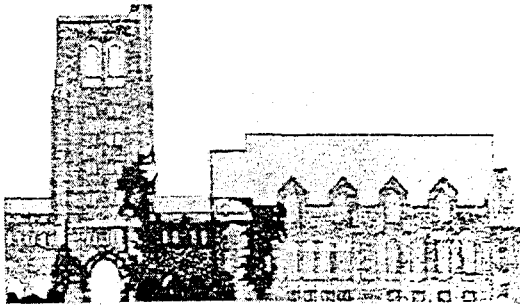
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APPENDIX B

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New York Telephone v. Public Service Commission, 2000 N.Y. Int. 71 (June 13, 2000)

REGULATORY OVERSIGHT - AGENCY AUTHORITY - JURISDICTION - JUDICIAL DEFERENCE - RATIONAL BASIS - UTILITIES

ISSUE & DISPOSITION

Issue(s)

Whether the State Public Service Commission's (PSC) order directing New York Telephone Company (NYT) to pass on to ratepayers the intrastate portion of its profit from the sale of Bell Communications Research, Inc. was valid.

Disposition

Yes. PSC's order directing NYT to pass on to ratepayers the intrastate portion of its profit from the sale of Bell Communications Research, Inc. was valid because PSC had rate regulation authority and the order had a rational basis.

SUMMARY

Bellcore was created as part of the AT&T antitrust divestiture. It was to be owned jointly by the newly created Regional Bell Operating Companies (one of which was NYT's parent company), providing research, development and other technical services. However, as the Regional Bell Operating Companies became more diverse and competition among them increased, it became less feasible to rely on a single source for technological research and development. They ultimately decided to sell Bellcore. NYT's request for a rate determination was pending before the PSC at the time the sale of Bellcore became known. PSC refrained from reopening the rate hearings to consider the possible impact of the sale of Bellcore, but did explicitly reserve the authority to adjust rates on account of the sale. PSC later approved the sale of Bellcore and further ordered NYT to submit a plan for passing on the intrastate portion of its profit to its ratepayers by giving them a surcredit in a future billing. NYT initiated a CPLR article 78 proceeding to annul the order.

The Court held that PSC had continued and consistent rate regulation authority with respect to the sale of Bellcore. But for NYT's stipulation in the rate proceeding that PSC retained jurisdiction to determine the appropriate ratemaking treatment of any proceeds, PSC would have granted the motion to reopen the hearings and would likely have ordered the surcredit before

approving the rate determination. Additionally, PSC expressly reserved judgment and jurisdictional authority to impose rate reductions with respect to proceeds from the sale.

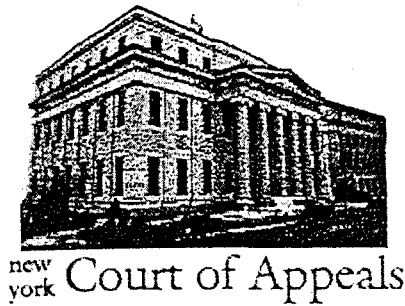
The Court also rejected NYT's alternate contention that ratepayers may only be permitted to share, through rate reduction, in gains from the sale of a corporate asset of a utility when they are obligated to bear at least some of the losses from any sale of that asset. The Court instead held that the standard of review of all rate determinations is one of flexibility and that PSC's determinations should not be set aside unless they were without rational basis. PSC was entitled to consider non-regulated asset transactions in setting rates or otherwise exercising its regulatory oversight of utilities for the benefit of ratepayers. Irrespective of whether a loss on the Bellcore sale could have been passed on to NYT's ratepayers, the PSC determined that NYT's customers were entitled to the benefit of the intrastate portion of the gains on the sale, because "NYT's interest in Bellcore has been funded through payments from ratepayers." The findings that Bellcores' costs were paid for by New York ratepayers satisfied the necessary rational basis for the order of a surcredit. The Appellate Division was reversed.

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3 No. 69
In the Matter of New York Telephone
Company,
Respondent,
v.
Public Service Commission of the State of
New York,
Appellant, and Eliot Spitzer, &c., et al.,
Intervenors-Respondents.

2000 NY Int. 71

June 13, 2000

This opinion is uncorrected and subject to revision before publication in the New York Reports.

Lawrence G. Malone, for appellant.
Richard W. Golden, for intervenor-respondent AG.
James F. Warden, Jr., for intervenor-respondent CPB.
Guy Miller Struve, for respondent.

LEVINE, J.:

The State Public Service Commission (PSC) appeals from the Appellate Division's annulment of its order directing petitioner New York Telephone Company (NYT) to pass on to ratepayers the intrastate portion of its profit from the sale of Bell Communications Research, Inc. (Bellcore), a shared subsidiary of the Regional Bell

Operating Companies (RBOCs). We reverse and remit.

Factual and Procedural History

NYT's interest in Bellcore is traceable to the 1984 antitrust divestiture of AT&T's wholly owned local operating companies (including NYT) into seven RBOCs, one of which was NYNEX, NYT's new parent company. Prior to that time, those operating subsidiaries obtained research and development and other technical services from another wholly owned AT&T subsidiary, Bell Telephone Laboratories (Bell Labs). Bellcore was created as part of the divestiture plan, to be owned jointly by the seven RBOCs and to provide the same services Bell Labs had previously furnished to AT&T's local telephone operating subsidiaries.

By 1995, as the seven RBOCs became more diverse and the possibility of competition among them increased, it became less feasible for them collectively to rely upon a single source for technological research and development. Therefore, they decided to sell Bellcore.

At the time that the plan to sell Bellcore became known, NYT's 1994 request for a multi-year rate determination, referred to as the Performance Regulation Plan (PRP), was pending before the PSC. Hearings on the request had been previously concluded. Upon disclosure of the prospective sale of Bellcore, various parties to the PRP rate proceeding moved to reopen the hearings for consideration of the impact of NYT's profits from that sale upon intrastate telephone rates under the plan. NYT argued against reopening of the hearings but agreed that if and when Bellcore was sold, the PSC would "retain the authority to determine the appropriate ratemaking treatment of any proceeds, notwithstanding any provision of the [PRP]." Based upon NYT's position, the PSC refrained from reopening the rate hearings. In August 1995, the PSC approved the PRP, explicitly reserving the authority to adjust rates on account of the sale of Bellcore.

In November 1996, the Bellcore Board of Directors, composed of officers of the RBOCs, formally resolved to sell Bellcore to an unrelated company called Science Applications International Corporation. In July 1997, NYT filed a petition with the PSC seeking a declaratory ruling disclaiming jurisdiction over the sale of Bellcore or, in the alternative, approval of the proposed sale. On November 7, 1997, the PSC approved the sale of Bellcore. It further ordered NYT to submit a plan for passing on \$19.5 million, the intrastate portion of its profit on the sale of Bellcore, to its ratepayers by giving them a surcredit of approximately \$2.50 each in a future billing.

NYT commenced this CPLR article 78 proceeding to annul the November 7 order to the extent that it required the distribution of the surcredit. Supreme Court confirmed the PSC's order and dismissed the

petition. The Appellate Division reversed (258 2 234), holding that the PSC lacked jurisdiction over the sale and that it could not order the surcredit under its ratemaking authority, an "after-the-fact justification" (*id.*, at 238). The court also concluded that even if the PSC had ratemaking jurisdiction, its determination was arbitrary, capricious and legally erroneous, and should be annulled. We granted leave to appeal.

Discussion

The primary ground urged by the PSC and intervenors, the State Attorney General and State Consumer Protection Board, for upholding the order for a surcredit is that it falls within the agency's authority to regulate rates for telephone service (*see*, Public Service Law §§ 91[1], 97[1], 4[1]) and has a rational basis. NYT contends that the PSC is barred from offering that justification because in ordering the surcredit the agency relied exclusively on its jurisdiction to approve or disapprove the Bellcore sale itself. NYT argues that the PSC's subsequent reliance on its ratemaking authority violates the rule limiting judicial affirmance of an administrative determination to the ground applied by the agency (citing *Matter of Scanlan v Buffalo Pub. School Sys.*, , 90 NY2d 662, 678).

The record does not support NYT's position that the sole original basis for the PSC's surcredit order was its assertion of jurisdiction over the sale of Bellcore. But for NYT's stipulation in the PRP rate proceeding that the PSC retained jurisdiction "to determine the appropriate *ratemaking* treatment of any proceeds" (emphasis supplied) from the Bellcore sale, the PSC would have granted the motion to reopen the hearings in that proceeding and, presumably, then gone on to order the surcredit before approving the PRP. Instead, at NYT's behest, the ratemaking aspect of the Bellcore sale was bifurcated in the PRP proceeding. The PSC's order approving the PRP expressly reserved judgment and jurisdictional authority to impose "rate reductions" with respect to "proceeds from the sale of assets that *were funded in whole or in part by [New York Telephone] ratepayers*" (emphasis supplied, brackets in original). Then, in the surcredit order itself, the explicit justification for imposing that one-time rate adjustment was precisely the same one the agency cited in the PRP approval when it reserved authority to reduce rates to reflect any eventual sale. The PSC ordered that the intrastate portion of NYT's Bellcore profits be passed on to its customers, because "NYT's interest in Bellcore *has been funded through payments from ratepayers*" (emphasis supplied).

The foregoing excerpts from the record are sufficient to demonstrate the continued and consistent assertion of rate regulation authority by the PSC with respect to the Bellcore sale: from the denial of the motion to reopen the hearings in the PRP rate proceeding, through the approval of the PRP, to the order imposing the single instance rate

reduction challenged here. As we said in *Matter of Rochester Tel. Corp. v Public Serv. Commn.* (87 2 17, 31), "we find no reason to require the incantation of certain 'magic' words" to signify either the assertion or the reason behind the exercise of the PSC's regulatory power over telephone service rates.^[1]

NYT alternatively contends that, even if the surcredit was imposed pursuant to the PSC's rate regulation authority, the ordering of the surcredit to reflect the intrastate portion of NYT's profit on the sale of Bellcore, a non-utility asset not included in its rate base, was contrary to well-established PSC and judicial precedents. NYT urges that both the PSC and the courts have consistently adhered to the rule that ratepayers may only be permitted to share, through rate reduction, in gains from the sale of a corporate asset of a utility when they are obligated to bear at least some of the risk of losses from any sale of that asset. The Appellate Division agreed, holding that "because ratepayers have no obligation to reimburse the utility for losses incurred on assets not held in its rate base, they are not entitled to share in the gain realized on the sale of such property" (258 2 at 238).

No such rigid formula exists. Rather, our cases establish that the standard of review of all PSC rate determinations, including those involving sales of assets, is one of flexibility. Repeatedly, we have held that the PSC's determinations in setting just and reasonable rates "are entitled to deference and may not be set aside unless they are without rational basis or without reasonable support in the record" (*Matter of Rochester Tel. Corp. v Public Serv. Commn.*, *supra*, at 29; *see also*, *Matter of Abrams v Public Serv. Commn.*, , 67 NY2d 205, 212, 218; *Matter of New York State Council of Retail Merchants v Public Serv. Commn.*, , 45 NY2d 661, 672; *Matter of Niagara Mohawk Power Corp. v Public Serv. Commn.*, , 69 NY2d 365, 369; *Matter of Campo Corp. v Feinberg*, 279 App Div 302, 307, *affd* 303 NY 995).

Judicial deference is warranted because "[s]etting utility rates presents 'problems of a highly technical nature, the solutions to which in general have been left by the Legislature to the expertise of the Public Service Commission'" (*Matter of Abrams v Public Serv. Commn.*, *supra*, at 211-212, citing *Matter of New York State Council of Retail Merchants v Public Serv. Commn.*, *supra*, at 672). Thus, in reviewing ratemaking determinations, "the courts * * * have not insisted upon a rigid approach" (*Matter of Abrams v Public Serv. Commn.*, at 214). To the contrary, "[t]he PSC is free to entertain or ignore any particular factor, or to assign whatever weight it deems appropriate" (*id.*, at 212).

NYT's position would also contravene case law that the PSC is entitled to consider non-regulated asset transactions in setting rates or otherwise exercising its regulatory oversight of utilities for the benefit of ratepayers. Thus, we held in *Matter of New York Tel. Co. v Public Serv. Commn.* (72 2 419) that even though Yellow Page advertising is

not a regulated service, the PSC had jurisdiction to disapprove a contract between NYT and a non-regulated affiliated company, under which the affiliate undertook the responsibility for providing such advertising to NYT's customers (*see, id.*, at 423; *see also, Matter of Rochester Tel. Corp. v Public Serv. Commn., supra* [imputing in a rate proceeding royalty income on unregulated transactions with non-utility affiliated corporations]; *Matter of General Tel. Co. of Upstate N.Y. v Lundy*, , 17 NY2d 373, 381 [overcharges by unregulated subsidiaries may be excluded from rate base]). As the Supreme Court stated in *Federal Power Commn. v Conway Corp.* (426 US 271), the consideration of nonjurisdictional transactions by regulators in setting utility rates for jurisdictional sales "would appear to be an everyday affair" (*id.*, at 280; *see also, Rochester Gas & Elec. v Public Serv. Commn.*, 754 F2d 99, 103 [2d Cir] [PSC may consider "nonjurisdictional activity in setting jurisdictional rates"])).

The PSC and court decisions NYT relies upon merely establish that ratepayer risk of loss on the sale of a utility's assets may serve as a rational basis for imposing a rate reduction reflecting a gain on such sales (*see, Spring Valley Water Co.*, 30 NYPSC 1831, 1840 [PSC Opinion No. 90-28]; *Matter of Spring Valley Water Co. v Public Serv. Commn.*, 176 AD2d 95, 99; *Matter of New York Water Serv. Corp. v Public Serv. Commn.*, 12 AD2d 122, 129; *Democratic Central Comm. of the Dist. of Columbia v Washington Metro. Area Tr. Commn.*, 485 F2d 786, 806-808 [DC Cir]). The converse -- that there can never be a rational basis for passing along to the ratepayers the profit from the sale of an asset when there might not have been a rate increase had the asset been sold at a loss -- simply does not follow.

The PSC may have a different, yet still entirely rational, basis for its determination to reflect the gain in a rate reduction.

Here, irrespective of whether a loss on the Bellcore sale could have been passed on to NYT's ratepayers, the PSC determined that NYT's customers were entitled to the benefit of the intrastate portion of the gains on the sale, because "NYT's interest in Bellcore has been funded through payments from ratepayers." That ground for the PSC rate determination has the requisite "reasonable support in the 'record'" (*Matter of Rochester Tel. Corp. v Public Serv. Commn., supra*, at 29; *Matter of Abrams v Public Serv. Commn., supra* at 212, 218; *Matter of New York State Council of Retail Merchants v Public Serv. Commn., supra*, at 672). The PSC submitted affidavits from the State Consumer Protection Board's lead analyst on telecommunications matters and a public utility auditor with expertise in the area of telecommunications regulation as it related to NYT, as well as testimony of Bellcore's Manager for Regulatory and Financial Systems Support. All of these experts lent support to the conclusion that the rate treatment the PSC gave NYT's payments to Bellcore for research and other services was exactly the same as if Bellcore were part of its rate

base and a division of NYT rather than a separate, unrelated entity.

Thus, the experts averred that initially, NYT's ratepayers funded Bell Labs, Bellcore's predecessor. Prior to the breakup of AT&T, calculation of the rates for telephone service to AT&T's and NYT's New York customers included charges for research and development and all other Bell Labs services integral to the operation of a telephone company. After divestiture, NYT's ratepayers continued to pay for the very same services provided by NYT's affiliates or subsidiaries, including Bellcore. Bellcore's prudent, fully allocable intrastate actual costs, *plus a regulated rate of return*, were paid for by New York ratepayers. The project costs which Bellcore charged to NYT included salaries and other direct expenses as well as indirect expenses and corporate costs. Thus, the costs paid for by NYT's ratepayers included a portion of Bellcore's total operating expenses as well as a return on investment paid to shareholders as dividends. The Commission authorized rate recovery of approximately \$720 million to pay for Bellcore's expenses.

In our judgment, the PSC's justification, based on ratepayers' funding of NYT's interest in Bellcore, affords a rational basis for the surcredit order. *Matter of Rochester Tel. Corp. v Public Serv. Commn.* (87 2 17, *supra*) supports the PSC's exercise of its authority here.

There, we upheld a PSC rate determination which imputed royalty income to the utility "to compensate ratepayers for the free transfer of intangible assets to RTC's [unregulated] affiliate" (*id.*, at 25). Those assets included the utility's "name and reputation" (*id.*, at 28). In that case, the petitioner, Rochester Telephone, objected on a ground similar to that asserted by NYT here, that those assets were not part of the rate base and, hence, transactions involving them, whether donated or sold, were beyond rate-making consideration. Thus, Rochester Telephone asserted that the PSC's order "improperly permits ratepayers to benefit from a non-rate-making asset because the utility does not earn a rate of return on the utility's name and reputation" (*id.*). Notwithstanding that those intangible assets were not included in the utility's rate base, we upheld the rate adjustment's imputation of royalties on transfers of those assets in *Rochester Tel. Corp.* because "the ratepayers have borne the costs for creating value in * * * those assets" (*id.*, at 29 [emphasis supplied]). Identically, here, because NYT's customers bore the costs of creating the intrastate portion of Bellcore's value, they are entitled to reap the corresponding share of NYT's gains on the sale of Bellcore.

Even if, as NYT contends, the risk of any loss on the sale of Bellcore would have been exclusively borne by NYT's shareholders, the reality was that in fully funding the Bellcore investment through telephone rates, NYT's customers effectively eliminated that risk, guaranteed the maintenance of Bellcore's value and funded Bellcore dividends to shareholders, including NYT (*see, Democratic Central Comm. of the*

District of Columbia v Washington Metro. Area Tr. Commn., supra, 485 F2d , at 806 ["an investor can hardly muster any equitable support for a claim to appreciation in asset value where he has been shielded against the risk of loss on his investment, or has already been rewarded for taking on that risk"]).

Accordingly, the order of the Appellate Division should be reversed, with costs, and the matter remitted to the Appellate Division for consideration of "additional contentions" (258 2 at 239) raised but not determined on the appeal to that court.

Order reversed, with costs, and matter remitted to the Appellate Division, Third Department, for consideration of "additional contentions" (258 2 234, at 239) raised but not determined on the appeal to that court. Opinion by Judge Levine. Chief Judge Kaye and Judges Bellacosa, Smith, Ciparick, Wesley and Rosenblatt concur.

Decided June 13, 2000

Footnotes

1 Moreover, NYT waived any entitlement to additional rate hearings it may have had under Public Service Law § 97(1). The PSC's decision not to address the rate treatment of the sale of Bellcore when it approved the PRP was based on NYT's explicit "understanding that no further hearings will be necessary."

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